OPENING STATEMENT OF
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SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT SPONSORED ENTERPRISES

HEARING ON RATING THE RATING AGENCIES: THE STATE OF TRANSPARENCY AND COMPETITION

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Mr. Chairman, for nearly a century rating agencies like Moody's, Standard and Poor's, and Fitch have published their views on the creditworthiness of the issuers of debt securities. The importance of these opinions has grown significantly in recent decades as a result of increases in the number of issues and issuers, the globalization of our financial markets, and the introduction of complex financial products, like asset-backed securities and credit derivatives.

As you know, Mr. Chairman, I have made investor protection one of my top priorities. I believe that strong regulation helps to protect the interests of America's investors. Accordingly, I am pleased that we have worked diligently during the last year to augment the resources available to the Securities and Exchange Commission, enact sweeping reforms of auditing and accounting practices, restore accountability to investment banking and analyst research, and improve the conduct of business executives and corporate boards.

Although rating agencies received some scrutiny after the recent spate of corporate scandals, we have not yet mandated any substantive change in their practices. At hearings before our Committee last year, however, one witness noted that the rating agencies "played a significant role" in Enron's failure. Additionally, a recent Senate investigative report found that the monitoring and review of Enron's finances "fell far below the careful efforts one would have expected from organizations whose ratings hold so much importance." I wholeheartedly agree. Outside of Arthur Andersen, the rating agencies probably had the greatest access to non-public information about Enron's complicated financial arrangements, and they exhibited a disappointing lack of diligence in their coverage of the company.

Furthermore, rating agencies have missed a number of other large-scale financial debacles over the last several decades. They failed to sound appropriate alarms before New York City's debt crisis in 1975 and the Washington Public Power Supply System's default in 1983. They also foundered before First Executive Life's collapse in the early 1990s and Orange County's bankruptcy in 1994. The failure of rating agencies to lower their ratings in these cases ultimately resulted in the loss of billions of dollars for American investors who little understood the true credit risks.

As a result of concerns about the role that rating agencies played in the recent downfalls of Enron, WorldCom and other companies, we called upon the Securities and Exchange Commission to study these issues and report back to us. In reviewing this report, it has become clear to me that while our capital markets and the rating industry have evolved considerably in recent decades the Commission's oversight and regulations in this area have changed little.

Moreover, it disturbs me that the Commission has studied this issue for more than a decade without reaching any firm conclusion. In 1992, for example, then-SEC Commissioner

Richard Roberts first noted that rating agencies -- despite their importance and influence -- remained the only participants in the securities markets without any real regulation. In 1994, the Commission also solicited public comment on the appropriate role of ratings in our federal securities laws and the need to establish formal procedures for recognizing and monitoring the activities of Nationally Recognized Statistical Rating Organizations. This release led to a rule proposal in 1997 that the Commission never finalized.

In releasing its latest rating agency report to the Congress in January, the Commission stated that it would issue within sixty days a concept paper asking questions about rating agency regulation. Sixty days have now passed. It is therefore my expectation that the SEC will publish its concept release as quickly as possible and that it will move with due diligence to finally resolve this issue and publish regulations regarding rating agencies.

Many others in the financial industry share my concerns. A recent survey by the Association for Financial Professionals found that ninety percent of treasury and finance professional believe that the Commission should take additional action to improve its oversight of the rating agencies. We are at a critical moment in the evolution of our capital markets and the SEC has a legitimate interest in ensuring the continued integrity of the rating agencies and the credit rating process.

As we proceed today, it is my hope that we will carefully examine the many issues raised in the recent SEC report on rating agencies. We must discern how the Commission should oversee rating agencies in a systematic way. We should also explore the conflicts of interest that rating agencies encounter, like their reliance on payments by issuers and their provision of consulting services to issuers. Last year, accountants came under fire for similar problems. We should additionally discuss the competitiveness of the credit rating industry. In particular, many critics have raised concerns about the ability of participants to enter the market.

Furthermore, I think that we should evaluate the ability of investors to understand credit ratings. In studying the recommendations of investment analysts two years ago, we heard stories about “buy” meaning “hold” and “hold” meaning “sell”. With respect to credit ratings, investors may well understand that “AAA” is an excellent credit risk with little probability of default and that “BBB+” means an acceptable credit risk with some chance of default, but they may not know that “B-”, a passing grade that their child might earn at school, signifies junk bond status. Average American investors need help in deciphering this convoluted code.

In closing, Mr. Chairman, I expect the Commission to take prompt and prudent action on rating agency regulatory issues. I also look forward to working with you on these matters as we move forward deliberately.